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EIW-23 February 78

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25X1A ONE ARTICLE FROM DER'S ECONOMIC INTELLIGENCE WEEKLY REVIEW
25X1A ENDING 23 FEBRUARY 1978. REQUEST ARTICLE BE PASSED TO AMBASSADOR,
25X1A DCM, ECONOMIC SECTION AND OTHER WORKING LEVEL STATE OFFICERS.

[REDACTED] PLEASE PASS TO US MISSION OECD.

[REDACTED] PLEASE PASS TO US MISSION TO EC.

PORTUGAL: ANOTHER ATTEMPT AT AUSTERITY.

1. THE THREE-WEEK-OLD COALITION GOVERNMENT HEADED BY PRIME MINISTER MARIO SOARES HAS GAINED PARLIAMENTARY CLEARANCE FOR NEW AUSTERITY MEASURES TO REDUCE THE OUTSIZED PAYMENTS DEFICIT. NEGOTIATIONS FOR A SMALL IMF LOAN ARE EXPECTED TO RESUME NEXT MONTH, INCREASING THE LIKELIHOOD OF MAJOR DISBURSEMENTS FROM A \$750 MILLION LOAN PACKAGE ARRANGED WITH VARIOUS FRIENDLY GOVERNMENTS. TALKS WITH IMF REPRESENTATIVES WERE SUSPENDED LAST NOVEMBER BECAUSE POLITICAL DISSENSION PREVENTED AGREEMENT IN LISBON ON MAJOR POLICY CHANGES NEEDED TO REDUCE THE CURRENT ACCOUNT DEFICIT. WITH COMMUNIST-DOMINATED LABOR UNIONS FANNING DISCONTENT OVER INFLATION AND UNEMPLOYMENT, SOARES WILL HAVE DIFFICULTY IMPLEMENTING THE LATEST BELT-TIGHTENING PROGRAM.

ECONOMIC DIFFICULTIES.

2. SINCE THE 1974 REVOLUTION, THE PORTUGUESE ECONOMY HAS BEEN BUFFETED BY POLITICAL TURMOIL, DECOLONIZATION, AND WORLD RECESSION. THE ENORMOUS INCREASES IN MONEY WAGES OF 1974-75 HAVE BEEN WIPE OUT BY INFLATION; IN THE FALL OF 1977 THE REAL WAGES OF LISBON INDUSTRIAL WORKERS WERE 3 PERCENT BELOW THE PREREVOLUTIONARY LEVEL. DOMESTIC INFLATION, LABOR UNREST IN BOTH INDUSTRY AND AGRICULTURE, BAD WEATHER, AND THE INCREASED COST OF IMPORTED OIL HAVE CONTRIBUTED TO EVEN HIGHER TRADE AND CURRENT ACCOUNT DEFICITS.

3. IN EARLY 1977 PRIME MINISTER SOARES, WHO FORMED

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THE PREVIOUS GOVERNMENT IN MID-1976, UNDERTOOK A SERIES OF AUSTERITY MEASURES INTENDED TO CURB CONSUMPTION AND IMPORTS AND ENCOURAGE INVESTMENT AND EXPORTS. HIS SOCIALIST PARTY HAD ONLY A MINORITY IN THE NATIONAL ASSEMBLY, AND ITS PROGRAMS WERE UNDERMINED BY POLITICAL AND SOCIAL UNREST AS WELL AS BY BUREAUCRATIC INEFFICIENCY. AS A RESULT, THE MEASURES WERE INSUFFICIENT AND OFTEN NOT FULLY IMPLEMENTED.

1977 PERFORMANCE.

4. LAST YEAR, INCREASED IMPORTS DUE TO HIGHER CONSUMER DEMAND, RISING INDUSTRIAL OUTPUT, AND CROP FAILURES RAISED THE CURRENT ACCOUNT DEFICIT BY ABOUT \$80 MILLION OVER 1976, TO \$1.3 BILLION, DESPITE SUBSTANTIAL GAINS IN EARNINGS FROM TOURISM AND WORKER REMITTANCES. THE MERCHANDISE TRADE DEFICIT PROBABLY REACHED \$2.4 BILLION IN 1977, COMPARED WITH \$2.1 BILLION IN 1976. THE POOR HARVEST, THE RESULT OF BAD WEATHER AND CONTINUING CONTROVERSY OVER AGRARIAN REFORM, WILL HURT THE TRADE BALANCE THROUGH MID-1978. AGRICULTURAL PRODUCTS MAKE UP HALF OF TOTAL IMPORTS.

5. FOREIGN EXCHANGE RESERVES PRESENTLY ARE FLUCTUATING BETWEEN \$100 MILLION AND \$300 MILLION, NO MORE THAN FOUR WEEKS OF IMPORTS. EVEN THIS LEVEL COULD NOT BE MAINTAINED WITHOUT SHORT-TERM BORROWING FROM WEST EUROPEAN BANKS. ABOUT ONE-HALF OF LISBON'S GOLD RESERVES, WORTH \$4 BILLION AT THE CURRENT MARKET PRICE, ALREADY HAVE BEEN PLEDGED AS COLLATERAL TO SECURE FOREIGN LOANS. THE FOREIGN DEBT, OF SMALL CONCERN BEFORE THE 1974 REVOLUTION, NOW AMOUNTS TO MORE THAN \$4 BILLION--EQUIVALENT TO NEARLY 20 PERCENT OF 1977 GNP. DEBT SERVICE LAST YEAR EQUALLED MORE THAN 25 PERCENT OF EXPORT EARNINGS.

6. REAL GNP ROSE AN ESTIMATED 5.5 PERCENT IN 1977, LED BY A SOLID UPTURN IN INDUSTRIAL PRODUCTION. PAY GUIDELINES HELPED KEEP WAGE INCREASES BELOW 15 PERCENT FOR THE SECOND STRAIGHT YEAR, PERHAPS THE MOST ENCOURAGING DEVELOPMENT FOR THE LONG-TERM HEALTH OF THE ECONOMY. ON THE OTHER HAND, PRIVATE INVESTMENT CONTINUED ANEMIC, AND UNEMPLOYMENT REMAINED AT ABOUT 15 PERCENT OF THE LABOR FORCE. STABILIZATION MEASURES, INCLUDING DEVALUATION, HIGHER INDIRECT TAXES, AND RELAXATION OF A BEWILDERING ARRAY OF PRICE CONTROLS, RESULTED IN A FURTHER INCREASE IN THE CONSUMER PRICE LEVEL. RETAIL PRICES IN LISBON ROSE AN ESTIMATED 30 PERCENT IN 1977, UP FROM THE 20-PERCENT RISE OF THE PREVIOUS YEAR.

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SEEKING REMEDIES.

7. HOPING TO BOLSTER THE CONFIDENCE OF INTERNATIONAL LENDERS, THE PORTUGUESE LAST APRIL NEGOTIATED A MINISTABILIZATION PACKAGE WITH THE IMF FOR THE RELEASE OF A FIRST TRANCHE LOAN OF \$50 MILLION. TALKS SUBSEQUENTLY HAVE CENTERED ON CONDITIONS FOR A SECOND TRANCHE OF \$50 MILLION. MORE THAN A DOZEN COUNTRIES AGREED LAST JUNE TO END PORTUGAL A TOTAL OF \$750 MILLION (INCLUDING \$300 MILLION FROM THE UNITED STATES), WITH DISBURSEMENTS IN MOST CASES CONTINGENT UPON A NEW IMF AGREEMENT. FACED WITH STRONG OPPOSITION IN THE NATIONAL ASSEMBLY, THE MINORITY SOCIALIST GOVERNMENT UNDER SOARES DECIDED NOT TO SUBMIT WHAT WOULD HAVE BEEN ITS THIRD MAJOR STABILIZATION PACKAGE AND RESIGNED UPON LOSING A VOTE OF CONFIDENCE LAST DECEMBER.

8. WITH THE BACKING OF PRESIDENT EANES, THE SOCIALIST PARTY HAS NOW FORMED AN ALLIANCE WITH THE CONSERVATIVE CENTER DEMOCRATS (PARTIDO DO CENTRO DEMOCRATICO SOCIAL) AND SOARES HAS RESUMED HIS ROLE AS PRIME MINISTER. THIS ALLIANCE ASSURES SOARES MAJORITY CONTROL OF THE ASSEMBLY--143 OF 263 SEATS. ON 12 FEBRUARY, THE NEW GOVERNMENT'S ECONOMIC PROGRAM PASSED THE ASSEMBLY AGAINST A DIVIDED OPPOSITION OF COMMUNISTS AND CENTER-RIGHT SOCIAL DEMOCRATS (PARTIDO SOCIAL - DEMOCRATA).

9. THE PROGRAM'S GOALS FOR THIS YEAR ARE TO REDUCE THE CURRENT ACCOUNT DEFICIT TO \$800 MILLION, LOWER THE INFLATION RATE TO 20 PERCENT, AND EXPAND REAL GNP BY ABOUT 4 PERCENT. ALTHOUGH DETAILS ARE SKETCHY, THE GOVERNMENT INTENDS TO:

10. HOLD DOWN THE BUDGET DEFICIT BY INCREASING TAXES AND KEEPING GOVERNMENT CONSUMPTION--AN EXPANSIONARY FACTOR IN RECENT YEARS--CONSTANT IN REAL TERMS.

11. STIMULATE FOREIGN AND DOMESTIC PRIVATE INVESTMENT BY RETURNING SOME HOLDINGS SEIZED BY WORKERS AND THE GOVERNMENT FOLLOWING THE REVOLUTION.

12. LIMIT THE EXPANSION OF DOMESTIC CREDIT, GIVING PREFERENCE TO EXPORT-ORIENTED, IMPORT-REPLACEMENT, AND LABOR-INTENSIVE ACTIVITIES.

13. THE OUTLINE OF THE PROGRAM APPEARS GENERALLY IN LINE WITH RECOMMENDATIONS PUT FORWARD BY THE IMF BEFORE

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TALKS WERE SUSPENDED IN NOVEMBER. ALTHOUGH THE NEW GOVERNMENT APPARENTLY HAS RULED OUT ANOTHER SIZABLE DEVALUATION, IT IS LIKELY TO FULFILL A PLEDGE MADE EARLIER TO ALLOW THE ESCUDO TO DEPRECIATE BY ABOUT 1 PERCENT EACH MONTH. THE ESCUDO ALREADY HAS GONE TO 40 PER DOLLAR FROM 25 AT THE TIME OF THE REVOLUTION. BOTH COALITION PARTIES ARE COMMITTED TO REACHING AGREEMENT WITH THE IMF, AND PARLIAMENTARY CLEARANCE OF THEIR PROGRAM HAS PAVED THE WAY FOR RESUMPTION OF TALKS, PROBABLY NEXT MONTH.

ROUGH ROAD AHEAD.

14. THE NEW COALITION GOVERNMENT FACES TOUGH GOING IN TRYING TO CARRY OUT ITS PROGRAM, AND SLIPPAGE IS LIKELY. WITH THE VOLUME OF INTRA-OECD TRADE PROJECTED TO INCREASE ONLY 4 TO 5 PERCENT, LISBON PROBABLY WILL MANAGE TO CUT THE CURRENT ACCOUNT DEFICIT SOMETHING LESS THAN THE PROJECTED HALF BILLION DOLLARS, LEAVING THE COUNTRY WITH A SERIOUS FINANCING PROBLEM. THE TARGETS FOR GOVERNMENT SPENDING AND GNP ARE LIKELY TO BE EXCEEDED BUT NOT ENOUGH TO MARKEDLY REDUCE UNEMPLOYMENT. AWARENESS OF PAST GOVERNMENT FAILURE TO FOLLOW THROUGH ON MUCH NEEDED ECONOMIC MEASURES AND CONTINUED ANTI-BUSINESS SENTIMENTS MAKE THE TASK OF RESTORING INVESTOR CONFIDENCE DOUBLY DIFFICULT. AGRICULTURAL RECOVERY SHOULD BE AIDED BY BETTER WEATHER, ALTHOUGH IT MAY BE CRIMPED BY COMMUNIST AGITATION. THE COMMUNISTS CONTROL MANY COLLECTIVE FARMS IN THE KEY GRAIN GROWING ALENTEGJO REGION.

15. THE SOCIALISTS AND CENTER DEMOCRATS UNDERTOOK THEIR ALLIANCE AT CONSIDERABLE RISK TO THEIR RESPECTIVE BASES OF SUPPORT AND, AS A RESULT, HAVE A GREAT STAKE IN MAKING THEIR POLICIES WORK. THE TASK WILL BE COMPLICATED, HOWEVER, BY THE DIVERGENT PHILOSOPHIES OF THE TWO GOVERNING PARTIES AND BY OPPOSITION FROM THE SOCIAL DEMOCRATS AND THE COMMUNISTS. THE COMMUNIST PARTY, WHICH CONTROLS UNIONS ENROLLING 80 PERCENT OF ORGANIZED LABOR, BEGAN STAGING A NUMBER OF STRIKES EARLY THIS MONTH. YET THE COMMUNISTS SEEM RELUCTANT TO RISK AN ALL-OUT CONFRONTATION WITH THE GOVERNMENT, WHICH COULD TURN PUBLIC OPINION AGAINST THEM. THEY SEEM CONVINCED THAT THE GOVERNMENT EVENTUALLY WILL FALL AND THAT A LEFTIST ALLIANCE OF SOCIALISTS AND COMMUNISTS CAN THEN BE FORMED. (CONFIDENTIAL) E1,2,3 IMPDET WNINTEL.>

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